(10)

No. 95-928

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

JOHN W. ATHERTON, JR.,

Petitioner,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, AS RECEIVER FOR CITY SAVINGS, F.S.B.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

REPLY BRIEF FOR PETITIONER

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August 30, 1996

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SUMMARY OF ARGUMENT

It is petitioner's position that, when the FDIC in its capacity as conservator or receiver of a failed federally chartered savings association sues the former directors and officers of that association for breach of their duty of care, it may assert a federal claim for gross negligence under 12 U.S.C. § 1821(k) or, if available, it may assert a state claim for simple negligence under the law of the state where the association has its principal place of business. The FDIC acknowledges that it has a § 1821(k) claim; but, in stark contrast to the position it has taken in other cases including, most recently, *FDIC v. Stahl*, 89 F.3d 1510 (11th Cir. 1996), the FDIC now argues that state law claims will not lie against the directors and officers of federally chartered associations because of the internal affairs doctrine pursuant to which courts resolve conflicts-of-law issues in cases involving the relations among or between a corporation, its directors, officers and shareholders, by applying the law of the state in which the corporation is incorporated. The FDIC maintains that in the case of a federally chartered association, it may not only sue officers and directors under § 1821(k) but that federal judges may also apply a simple negligence liability standard as a matter of federal common law.

The FDIC fails to satisfy either of the two necessary preconditions to the application of federal common law. It has identified neither any unique federal interest that would warrant the application of a federal common law liability standard nor any significant conflict between any such federal interest and the use of applicable state law liability standards for directors and officers. Even where a unique federal interest exists, the presence of such a conflict is "uniformly require[d] . . . as a precondition for recognition of a federal rule of decision." *O'Melveny & Myers v. FDIC*, 114 S. Ct. 2048, 2055 (1994). The internal affairs doctrine is not an impediment to the maintenance of state law breach of duty claims against the directors and officers of federally chartered institutions. This Court and many lower courts (often at the FDIC's own urging) have recognized that federal law is not the exclusive source of law respecting the internal affairs of corporations merely because they are federally chartered. And, in any event, § 1821(k) supplants any federal common law simple negligence liability standard that otherwise might exist.

ARGUMENT

I. PETITIONER HAS ADEQUATELY RAISED THE ISSUE OF THE APPLICABILITY OF FEDERAL COMMON LAW

The FDIC suggests that the Court may not wish to address the issue of whether federal common law governs the liability of directors and officers of federally chartered savings institutions because petitioner allegedly first raised that issue in his opening brief. (FDIC Br. 7, 9-12.) The FDIC's position is factually misguided. The second of the Questions Presented in the Petition for a Writ Of Certiorari (Petition) is "[w]hether the court of appeals erred in concluding that Section 1821(k) . . . has *no* application whatsoever to [FDIC] actions against officers and directors of failed *federally* chartered FDIC insured institutions, *and that the liability of officers and directors of such institutions is instead governed exclusively by 'federal common law.'* (Pet. i (last emphasis added).) This directly raises the issue of the applicability of federal common law. At the least, the issue is "fairly included" in the question presented. *See* Sup. Ct. R. 14.1(a).

To leave no doubt, immediately following the second of the Questions Presented, the following statement appears: "[T]he decision of the court of appeals is in irreconcilable conflict with . . . (iii) this Court's well-established prior rulings concerning the creation and application of 'federal common law,' including especially this Court's recent decision in *O'Melveny & Myers v. FDIC* . . . ." (Pet. i.) Moreover, the second of the "Reasons For Granting The Writ" is that "the [court of appeals's] conclusion that 'federal common law,' instead of Section 1821(k), supplies the applicable law in this case violates this Court's longstanding rules respecting the creation and application of such judge-made law . . . ." (Pet. 8.) And the entire section II of the Petition (Pet. 16-20) is devoted to the following subject: "The Third Circuit's Decision Is In Direct Conflict With This Court's Prior Rulings Respecting The Application Of 'Federal Common Law,' And Particularly Its Recent Decision In *O'Melveny & Myers v. FDIC*." (Pet. 16.) Petitioner has thus amply raised the issue of the applicability of federal common law.

Even if the Petition had only presented the question whether § 1821(k) supplants a federal common law liability standard, it

would still be appropriate for the Court to first ascertain whether such a standard exists.[1] In *Lebron v. National Railroad Passenger Corp.*, the Court considered whether Amtrak is a government actor rather than a private entity even though petitioner there "did not raise [the] point below; indeed, he expressly disavowed it in both the District Court and the Court of Appeals." 115 S. Ct. 961, 964 (1995).[2] The Court reasoned that the question of private-entity status was a "prior question" that needed to be addressed even if not raised in the certiorari petition. *Id.* at 966. Similarly, whether a federal common law liability standard for directors and officers of federally chartered savings institutions even exists is a "prior question" to whether § 1821(k) supplants it. *See also Caspari v. Bohlen,* 114 S. Ct. 948, 953 (1994); *Cuyler v. Sullivan,* 446 U.S. 335, 342 n.6 (1980).

II. FEDERAL COMMON LAW SHOULD NOT APPLY MERELY BECAUSE CITY FEDERAL WAS FEDERALLY CHARTERED

The FDIC contends that, under 12 U.S.C. § 1821(d)(2)(A)(i), it "stands in City Federal's shoes and possesses the right to assert City Federal's federal common-law claims against its former officers and directors." (FDIC Br. 28.) City Federal, however, had no such claims. Corporate negligence and breach of fiduciary duty claims are matters of state, not

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[1] As observed in petitioner's opening brief, it is not *necessary* for the Court to decide whether a federal common law liability standard exists. (Br. 14.) It may assume the existence of such a standard and then determine that § 1821(k) supplants it. However, to rule in the FDIC's favor, the Court would have to determine *both* that a federal common law liability standard exists *and* that § 1821(k) does not supplant it.

[2] The FDIC chides petitioner for having changed his position regarding the applicability of federal common law. (FDIC Br. 9-10.) It is true that, at the district court level, petitioner assumed the existence of a federal common law liability standard. That, however, was *before* the *O'Melveny* decision. After *O'Melveny*, petitioner has consistently recognized that there is no federal common law to apply. Thus, in his brief to the Third Circuit, petitioner stated: "[*O'Melveny*] sounds the death knell on the [FDIC's] effort to construct a federal common law theory to govern this case." (Br. Appellees 21.) The Petition takes the same position. (Pet. i-ii, 8-10, 16-20.) Thus, petitioner's contention is not "new." (FDIC Br. 11.)

federal, law.[3] The fact that City Federal was federally chartered does not alter this conclusion. This is especially so where, as in this case, (i) Congress has enacted a comprehensive scheme governing federally chartered savings associations but has not included a federal standard of director and officer liability; (ii) the FDIC has failed to identify any "uniquely federal interest" that would be served by the application of a uniform federal common law rule of decision, *see Boyle v. United Technologies Corp.*, 487 U.S. 500, 507 (1988); (iii) the FDIC has not identified any "significant conflict" between any federal interest and the application of state law liability standards for directors and officers, *see O'Melveny & Myers v. FDIC*, 114 S. Ct. 2048, 2055 (1994); (iv) the federal agency that has regulatory authority over federal savings associations — the Office of Thrift Supervision (OTS) — has refrained from promulgating any regulations establishing a uniform standard of liability; and (v) the agency that regulates national banks — the Office of the Comptroller of the Currency (OCC) — has expressly authorized the use of state law standards with respect to corporate governance of such banks.

The FDIC cites the Court's 1891 opinion in *Briggs v. Spaulding* for the proposition that "[w]hen Congress enacted the National Bank Act in 1864 and [the Home Owners' Loan Act] in 1933, . . . it was firmly established at general common law that those directors and officers would owe a fiduciary duty of care to the institutions, the breach of which would be redressable by the institutions." (FDIC Br. 21.) Accordingly, asserts the FDIC, "Congress not unreasonably left it to the courts, applying common law, to enforce those duties." (*Id.*) As the FDIC concedes, however, *Briggs* was decided before the Court's pronouncement in *Erie R. Co. v. Tompkins* that "[t]here is no federal general

[3] The standard of director and officer liability falls squarely within two traditional areas of state law: tort law, *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938), and corporation law, *Burks v. Lasker*, 441 U.S. 471, 478 (1979). This Court has consistently refused to fashion a federal rule of decision regarding an issue that falls within an area traditionally governed by state law. *See United States v. Yazell*, 382 U.S. 341, 352 (1966); *United States v. Brosnan*, 363 U.S. 237, 242 (1960); *Reconstruction Fin. Corp. v. Beaver County*, 328 U.S. 204, 210 (1946).

common law," 304 U.S. 64, 78 (1938). Thus, granting the existence of a *general* common law duty of care owed by directors and officers of federal savings associations prior to the enactment of the Home Owners' Loan Act of 1933 (HOLA) does not resolve the issue of whether the courts are to apply state law standards of liability or to create a uniform federal standard.

The FDIC has not identified any existing federal statute or regulation either defining the standard of liability for directors or officers of federally chartered savings associations or explicitly authorizing courts to do so. The comprehensive federal statute that governs the creation, operation and regulation of such associations, HOLA, is silent on the matter. *See* ch. 64, 48 Stat. 128 (codified as amended in scattered sections of 12 U.S.C.). The FDIC acknowledges that "Congress has not expressly defined the duties owed by officers and directors of federally chartered depository institutions." (FDIC Br. 21.) *See also Curiale v. Reissman*, 798 F. Supp. 141, 148 (S.D.N.Y. 1992) ("Although HOLA and other statutes and extensive federal regulations define many aspects of the constraints on and operation and obligations of federal savings institutions, they neither define the duties of savings bank directors nor grant federal jurisdiction over disputes involving those duties.").

When statutory authority is absent, federal courts generally may apply federal common law only when some "uniquely federal interest" is present. *Boyle*, 487 U.S. at 507. Such an interest is one "of peculiarly federal concern," *id.* at 505, in which "the interests of the United States will be directly affected," *id.* at 507. The Court found uniquely federal interests in *Boyle* because the application of state tort law in resolving death or injury claims of military personnel could directly affect the interests of the United States in its military procurement programs. *Id.* at 510-13. The Court has also found uniquely federal interests in cases involving: the rights and liabilities of the United States under nationwide programs involving the lending of federal funds by federal agencies, *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 726-27 (1979); the rights and obligations of the United States under contracts entered into pursuant to authority conferred by federal statute, *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 594 (1973); the civil liability of federal

officials for actions taken in the course of their duties, *Howard v. Lyons*, 360 U.S. 593, 597 (1959); and the rights and duties of the United States on commercial paper issued by it, *Clearfield Trust Co. v. United States*, 318 U.S. 363, 366 (1943). The common ingredient in all of these cases is that an interest of the United States — generally a financial one — is directly involved and would be immediately affected by the outcome of the litigation.

There simply are no unique federal interests that justify the creation or application of federal common law liability standards for directors and officers of federally chartered savings associations. Although City Federal was federally chartered and regulated, it was a privately owned business corporation. "Where 'litigation is purely between private parties and does not touch the rights and duties of the United States,' . . . federal law does not govern." *Boyle*, 487 U.S. at 506 (quoting *Bank of Am. Nat'l Trust & Sav. Ass'n v. Parnell*, 352 U.S. 29, 33 (1956));[4] *see also O'Melveny*, 114 S. Ct. at 2055 ("The rules of decision at issue here do not govern the primary conduct of the United States or any of its agents or contractors, but affect only the FDIC's rights and liabilities, as receiver, with respect to primary conduct on the part of private actors that has already occurred."). Had City Federal sued petitioner for breach of duty in a New Jersey court, no federal agency or official would have been a party to the suit or had any direct stake in its outcome. The FDIC has made no showing that any rights, interests or obligations of the United States would be affected in the least if state law, rather than federal common law, were applied in such cases.

It is, of course, true that the FDIC insures the deposit accounts of federally insured savings associations and that, if such an institution becomes insolvent, the interests of the FDIC are directly affected. But, under § 1821(d)(2)(A)(i), upon which the FDIC here relies, the FDIC steps into the shoes of the association and asserts any claims the association could have

[4] In *Boyle*, the Court determined that federal common law applied despite the fact that the suit involved private parties. But there, the United States had a strong interest in the potential liability of government contractors because it would affect not only the government's ability to enter into contracts but also the prices of the equipment purchased. 487 U.S. at 510-13.

asserted *when it was solvent*. With respect to *those* claims — to which the FDIC asserts federal common law should be applied — the FDIC would have had *no* direct financial interest. *See O'Melveny*, 114 S. Ct. at 2055. Nor would any other financial interests of the United States be implicated. There being no such affected interests, the predicate for the application of federal common law to such claims simply does not exist. The FDIC's reliance on *Kimbell Foods* and *Clearfield Trust* (FDIC Br. 19-20), in which the financial interests of the United States were directly involved and would have been affected by the outcome, is thus wholly misplaced.

Moreover, the FDIC acts as insurer of deposits in both federally and state chartered institutions. 12 U.S.C. §§ 1814, 1815. If the FDIC's role as insurer were a sufficient "uniquely federal interest" to require application of a federal common law standard of liability for officers and directors of federally insured institutions, such a standard would have to be applied to both state and federally chartered institutions, a result that the FDIC does not seek and that this Court rejected in *O'Melveny*. 114 S. Ct. at 2055.

Under *Boyle*, if, as in this case, a unique federal interest cannot be identified, that ends the inquiry as to whether federal common law should be applied; it may not be. Thus, plaintiff's claims arise, if at all, under state law.[5] But even where a unique federal interest is identified — and the precondition for applying federal common law has been satisfied — state law still will be displaced by a uniform federal common law rule of decision "only where . . . a 'significant conflict' exists between an identifiable 'federal policy or interest and the [operation] of state law,' or the application of state law would 'frustrate specific objectives' of federal legislation." *Boyle*, 487 U.S. at 507 (citations omitted); *see also O'Melveny*, 114 S. Ct. at 2055 ("Our cases

[5] If a unique federal interest does not exist, then, absent an applicable constitutional provision or federal statute or regulation, the controversy is not governed by federal law. State law applies of its own force and not simply as a "federal rule of decision." In the instant case, this distinction is significant because the FDIC has waived any state law claims it otherwise may have had.

uniformly require the existence of such a conflict as a precondition for recognition of a federal rule of decision."). The FDIC does not demonstrate that the application of state law here would create any "significant conflict" between any identifiable federal policy or interest or would frustrate specific objectives of federal legislation. No such policies, interests or objectives are mentioned.

The only conflict even suggested by the FDIC is one that allegedly might arise between state law and the standards of liability applied by the OTS, the chartering authority of federal savings associations, in administrative enforcement proceedings. (FDIC Br. 22-27.) The FDIC contends that in two such proceedings applying an ordinary care standard of liability, the OTS "spoke[] authoritatively respecting the duty of care owed by directors and officers to federal savings associations." (*Id.* at 24-25.) The FDIC's attempt to manufacture a conflict on this basis, however, is deficient for several reasons.

First, the FDIC fails to mention that both proceedings it cites involved *state*-chartered associations and, therefore, have no direct bearing on liability standards for directors and officers of federally chartered associations. The reference to an ordinary care standard in administrative enforcement actions relating to state-chartered institutions simply fails to demonstrate any federal policy or interest in having that standard, or indeed any standard, applied nationwide as federal common law in civil suits involving federally chartered institutions. The FDIC cites no authority for any such proposition.[6] Second, the decisions of the OTS in the cited proceedings were not based on a failure of the directors therein to satisfy a "simple negligence" standard.

[6] The FDIC notes that "[t]he OTS has also published substantial informal guidance respecting the duties of officers and directors," referring to four memoranda that purport to apply to all savings associations, regardless of charter. (FDIC Br. 25 n.21.) However, those memoranda were never promulgated as regulations, and they were published in 1992, 1990, 1989 and 1987, respectively. The last of the three loans that give rise to the allegations against petitioner was made in 1986. (Second Am. Compl. ¶¶ 38, 56, 72, 74.) Accordingly, the informal guidelines, even if otherwise constituting applicable law (which the FDIC nowhere establishes), can have no applicability here.

Rather, they involved conduct that failed the statutory standards established by Congress in 12 U.S.C. § 1818 (or its predecessor), which requires, at a minimum, a showing that the director or officer was "unjustly enriched" or demonstrated "a reckless disregard for law or any applicable regulation," 12 U.S.C. § 1818(b)(6)(A). Thus, the *holdings* of those decisions do not conflict with petitioner's position. Third, to the extent the agency dicta cited by the FDIC from the OTS cases espouse a standard of liability for directors or officers beyond that in 12 U.S.C. § 1818, the authority of the OTS to set such a standard in those proceedings is questionable.[7]

It is difficult to argue — and the FDIC does so only half-heartedly (*e.g.*, FDIC Br. 8, 27) — that there is a federal interest in ensuring that directors and officers of federally chartered associations are subject to a uniform standard of liability. If such an interest exists, it is difficult to understand why Congress or the OTS or its predecessor, the Federal Home Loan Bank Board (FHLBB), have never bothered to establish such a uniform standard, by law or regulation.[8] Clearly, the FHLBB had, and the OTS has, "plenary authority" over federally chartered savings associations. *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982). Yet, in the 63 years since the enactment of HOLA, they never have promulgated any regulation that even purports to establish liability standards for directors and officers of such associations. In any event, the FDIC's suggestion that application of state law standards of liability, rather than a single

[7] Indeed, many states apply a gross negligence standard of liability for directors and officers rather than the "ordinary care" standard the FDIC indicates the OTS would apply. *See* Ronald W. Stevens & Bruce H. Nielson, *The Standard of Care for Directors and Officers of Federally Chartered Depository Institutions: It's Gross Negligence Regardless of Whether § 1821(k) Preempts Federal Common Law*, 13 Ann. Rev. Banking L. 169, 194-218 (1994) (identifying states that apply a gross negligence standard of liability to directors and officers).

[8] Congress obviously does not share the FDIC's concern that the standard of liability for federally chartered savings associations must be uniform and, therefore, must avoid application of state law standards of liability. As petitioner observed in his opening brief (Br. 44), in § 1821(k) Congress provided that the term "gross negligence" shall be "defined and determined under applicable state law."

federal standard of simple negligence, "would undermine the OTS's ability to implement its own coherent and uniform regulatory policy" with respect to federal savings associations (FDIC Br. 27) is not well taken.

This is true for two reasons in addition to the above. First, the OTS will retain the ability to bring enforcement actions under 12 U.S.C. § 1818(b)(6)(A) to impose remedies of the type sought in this case (*i.e.*, compensation for losses) against directors and officers of *any* savings association, regardless of its charter, based on the standard set forth in that statute. Thus, uniformity based on that standard can be achieved. More significantly, to the extent that Congress has addressed a need for uniformity in the standard of liability applied to directors and officers in cases like this seeking compensation for losses, it imposes liability *not* for simple negligence, but where the director or officer has been "unjustly enriched" or acted with "reckless disregard for law or any applicable regulation or prior order." 12 U.S.C. § 1818(b)(6)(A). Thus, not only will the OTS retain the ability to achieve uniformity, but the uniform standard Congress has enacted with respect to OTS administrative proceedings seeking compensation for losses, as here, is not the simple negligence standard the FDIC seeks to have applied in this case.

Moreover, if uniformity were an important federal interest in corporate governance matters for federally chartered depository institutions, then it is virtually incomprehensible that the OCC — the federal chartering authority for national banks — would have issued a regulation this year "that provides national banks with maximum flexibility to structure their corporate governance procedures," 61 Fed. Reg. 4849, 4854 (1996), by authorizing such banks "[t]o the extent not inconsistent with applicable Federal banking statutes or regulations, or bank safety and soundness, . . . to follow the corporate governance procedures of the law of the state in which the main office of the bank is located, the law of the state in which the holding company of the bank is incorporated, the Delaware General Corporation Law, . . . or the Model Business Corporation Act . . . ," *id.* at 4866 (to be codified at 12 C.F.R. § 7.2000(b)). The OCC obviously believes that, so long as each national bank is subject to some settled law, it is not significant that the law may

vary for institutions, and their directors and officers, from state to state, or indeed from institution to institution.

The FDIC quotes *Kimbell Foods* for the proposition that, when " 'Congress has not spoken in an area comprising issues substantially related to an established purpose of government operation . . . [then] *Clearfield* directs federal courts to fill the interstices of federal legislation.' " (FDIC Br. 21-22.) The authority to fill interstices, however, does not imply a power to add entirely new substantive provisions to a statutory scheme that Congress did not see fit to include. This is particularly true for a comprehensive statutory scheme such as HOLA. As the Court stated in *O'Melveny:* "[M]atters left unaddressed in such a scheme are presumably left subject to the disposition provided by state law." 114 S. Ct. at 2054; *see also Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 98 (1991) ("[A] court should endeavor to fill the interstices of federal remedial schemes with uniform federal rules only when the scheme in question evidences a distinct need for nationwide legal standards . . . .").

Not otherwise able to meet the criteria for applying federal common law that *Boyle* and *O'Melveny* pronounce, the FDIC urges that federal common law should apply to federally chartered savings associations for no other reason than that they are federally chartered. Drawing on the Seventh Circuit's split decision in *RTC v. Chapman*, the FDIC asserts: "Just as the internal affairs of a state-chartered corporation are governed by the law of the chartering State, so federal law governs the internal affairs of federally chartered institutions." (FDIC Br. 18.)[9] While various district courts have reached that conclusion (FDIC Br. 14 n.9), and one circuit court (the Seventh Circuit) has done so, this Court has never suggested that federally chartered institutions are subject to federal common law rather than state law merely by virtue of their federal charters.

[9] The FDIC fails to mention, however, that the federal rule of decision that *Chapman* applied is the gross negligence standard of § 1821(k). *See* 29 F.3d 1120, 1123 (7th Cir. 1994). The Seventh Circuit reasoned that it was unnecessary for federal courts to "devise federal common law" liability standards because "Congress has laid down the law" in enacting the gross negligence standard in § 1821(k). *Id.*

Quite the contrary. The Court has made clear that national banks, which operate under a federal charter,[10] "are subject to the laws of a State in respect of their affairs unless such laws interfere with the purposes of their creation, tend to impair or destroy their efficiency as federal agencies or conflict with the paramount law of the United States." *First Nat'l Bank v. Missouri*, 263 U.S. 640, 656 (1924); *see also Anderson Nat'l Bank v. Luckett*, 321 U.S. 233, 248 (1944) ("[N]ational banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions.").

This is true not only for matters affecting the dealings of national banks with third parties but for matters affecting the internal affairs of such banks. Especially persuasive in this regard is the Court's decision in *Herrmann v. Edwards*, 238 U.S. 107 (1915). There the internal affairs of a national bank were unquestionably at issue, yet it was determined that there was no federal cause of action merely because the national bank had a federal charter. *Id.* at 116. *Herrmann* involved a suit by shareholders of a national bank against its directors for breach of trust in approving an improvident merger. Noting that "[t]here was no diversity of citizenship and jurisdiction over the suit therefore depended on whether there was a Federal cause of action," *id.* at 115-16, the Court stated: "[I]n the absence of a Federal controversy concerning the interpretation of some provision of the National Bank Act raising what might be considered by analogy a Federal question . . . , a mere assertion of liability on the part of directors for wrongs for which they might be responsible at common law, afford[s] no basis for jurisdiction," *id.* at 112; *see also Whittemore v. Amoskeag Nat'l Bank*, 134 U.S. 527, 530 (1890) (holding that federal courts have no jurisdiction over a suit by shareholders of a national bank against directors of the bank who allegedly breached their duties to shareholders by approving a bank loan without adequate security).

[10] In this area, the FDIC regards case authority applicable to national banks also to be applicable to federally chartered savings associations. (FDIC Br. 17-18.)

Herrmann and *Whittemore* both clearly stand for the proposition that federal law does not apply to the internal affairs of a federally chartered depository institution merely because of the source of its charter. The FDIC is thus quite mistaken when it asserts, with respect to national banks, that "this Court has never suggested that state law controls matters relating to their internal corporate governance," (FDIC Br. 18). State law governs the internal affairs of such institutions so long as it does not conflict with the laws of the United States or impose an undue burden on the performance of the institution's functions.

At the lower federal court and state court levels, a number of cases have similarly ruled that national banks are subject to state law in matters affecting their internal affairs. [11] Even more to the point, a significant number of cases — particularly those decided post-*O'Melveny* — have held that the directors and officers of federally chartered savings associations are subject to state law breach of duty claims, and have either explicitly or implicitly

[11] *See, e.g., Morast v. Lance*, 807 F.2d 926, 929 (11th Cir. 1987) ("The district court did not have subject matter jurisdiction [of a suit by a bank officer against the bank for wrongful dismissal] merely because the defendant bank was a federally chartered bank."); *Maxwell v. First Nat'l Bank*, 638 F.2d 32, 34-35 (5th Cir. 1981) (characterizing shareholder suit challenging national bank consolidation as "a state law claim" and stating that "[n]ational banks are . . . subject to state law to the extent such law does not conflict with the laws of the United States"); *Austin v. Altman*, 332 F.2d 273, 276 (2d Cir. 1964) (holding that suit by national bank shareholders against directors regarding stock subscriptions is a matter of state law, not federal law); *Country Nat'l Bank v. Mayer*, 788 F. Supp. 1136, 1141-42 (E.D. Cal. 1992) ("[N]othing in the [National Bank Act] suggests a conflict with a state's demand and futility requirement in the context of a shareholder derivative suit, nor does the statute suggest that application of state law would impose an undue burden on the Bank's functions."); *Bank of Am. Nat'l Trust & Sav. Ass'n v. Ryan*, 207 Cal. App. 2d 698, 705, 24 Cal. Rptr. 739, 743 (1962) (deciding state law breach of fiduciary duty claim brought by national bank against officer); *First Nat'l Bank v. Hall*, 143 Ga. App. 300, 301, 238 S.E.2d 284, 285 (1977) (same); *Borgsmiller v. Burroughs*, 187 Ill. App. 3d 1, 6, 542 N.E.2d 1281, 1285 (1989) (deciding state law breach of fiduciary duty claim brought by national bank shareholders against directors), *appeal denied*, 128 Ill. 2d 661, 548 N.E.2d 1066 (1990).

rejected application of the internal affairs doctrine.[12] Particularly noteworthy, in light of the FDIC's position herein, is the Eleventh Circuit's recent decision in *FDIC v. Stahl*, 89 F.3d 1510 (11th Cir. 1996). At the express urging of the FDIC, the court there applied state law as the applicable standard of liability for directors and officers of a federally chartered savings association. The court dismissed out-of-hand, as "without merit" and "not warrant[ing] discussion," the contention of the directors and officers that the internal affairs doctrine required the exclusive application of federal law. *Id.* at 1515 n.10.

In diametric opposition to its position herein, the FDIC in *Stahl* sharply criticized the Seventh Circuit's *Chapman* decision, stressing that "the panel's internal affairs doctrine analysis has

[12] The FDIC creates a misleading impression that the "vast majority of courts" have ruled that federal law must apply to federally chartered depository institutions and that only "a small number of courts have applied state law." (FDIC Br. 14 & n.9.) Certainly, of the more recent cases, more have been decided favorably to petitioner's position than to the FDIC's. *See, e.g., FDIC v. Abel*, 92 Civ. 9175 (JFK), 1995 U.S. Dist. LEXIS 18159, at *7 (S.D.N.Y. Dec. 5, 1995) ("Plaintiff may bring state law claims against a federally chartered bank."); *RTC v. Williams*, 887 F. Supp. 1415, 1420 (D. Kan. 1995) ("There is no general federal corporation law which sets out the standard of care imposed on the officers and directors of federally-chartered financial institutions."); *RTC v. Shuck*, Civ. Act. No. 93-12057-WGY, 1995 U.S. Dist. LEXIS 4314, at *8 (D. Mass. Mar 29, 1995) ("This Court agrees with other circuits finding a distinction between state and federal financial institutions based upon the source of the charter to be without merit."); *FDIC v. Raffa*, 882 F. Supp. 1236, 1244 (D. Conn. 1995) ("[T]he mere fact that [CNB] is federally chartered does not immunize [CNB's officers and directors] from [liability under] state law."); *RTC v. Gregor*, 872 F. Supp. 1140, 1146 (E.D.N.Y. 1994) ("[P]re-FIRREA state law provided the applicable standard of liability of directors of federally-chartered savings and loans."); *RTC v. Fiala*, 870 F. Supp. 962, 969 (E.D. Mo. 1994) ("The Court finds the state/federal distinction . . . nonsensical."); *RTC v. Rahn*, 854 F. Supp. 480, 489 (W.D. Mich. 1994) (applying state statutory duty of care to directors of federally chartered savings association); *RTC v. Heiserman*, 839 F. Supp. 1457, 1462 (D. Colo. 1993) (same); *RTC v. Gibson*, 829 F. Supp. 1103, 1109 n.2 (W.D. Mo. 1993) ("There is nothing to suggest that officers and directors of federally chartered institutions are only subject to federal causes of action."); *AmeriFirst Bank v. Bomar*, 757 F. Supp. 1365, 1374 (S.D. Fla. 1991) (same as *Rahn* and *Heiserman*).

been criticized *and was in the FDIC's view erroneously applied.*"[13] The FDIC also argued, again in complete opposition to its position herein, that the "argument that only federal law governs this case . . . is wrong."[14] Given the almost exact correspondence between the facts of *Stahl* and the instant case, petitioner finds it difficult to understand how the FDIC there could have found the internal affairs doctrine wholly inapplicable while here virtually dispositive, and the argument that only federal law governs federally chartered institutions there "wrong" and here right.

The FDIC suggests in this case that the internal affairs doctrine should be applied to ensure that, where associations are engaged in multi-state lending activities, their directors and officers will not be subject to conflicting state fiduciary requirements. (FDIC Br. 15.) That potential complication is easily obviated, however, by applying the law of the state where the association has its principal place of business.[15] It is not necessary to resort to federal common law to achieve that result. Indeed, doing so creates two different standards of liability for directors and officers of financial institutions within the same state (even on the same block) depending on the source of the institution's charter. That seems neither equitable nor effective given the ease with which an institution may convert back and forth between state and federal charters. 12 U.S.C. §§ 35, 214a, 1464(i), (o).

[13] Appellant's/Cross-Appellee's Brief at 27, *FDIC v. Stahl*, 89 F.3d 1510 (11th Cir. 1996) (emphasis added).

[14] *Id.* at 1.

[15] *See, e.g., Country Nat'l Bank v. Mayer*, 788 F. Supp. at 1141 (applying state law of national bank's principal place of business to determine demand and futility requirements); *In re Orfa Sec. Litig.*, 654 F. Supp. 1449, 1455 (D.N.J. 1987) (applying law of principal place of business rather than law of state of incorporation to govern fiduciary obligations of corporate officers); *see also* 61 Fed. Reg. 4849, 4866 (1996) (to be codified at 12 C.F.R. § 7.2000(b)) (authorizing national banks "to follow the corporate governance procedures of the law of the state in which the main office of the bank is located"); *RTC v. Everhart*, 37 F.3d 151, 154 (4th Cir. 1994) ("This case well illustrates the difficulty of determining the rule of decision if federal law, the law of the chartering jurisdiction, is applied instead of the law of the S & L's principal place of business.").

It is, moreover, difficult to take the FDIC's protestations of the need for uniformity and the exclusive application of federal law seriously when the FDIC and its predecessor, the Resolution Trust Corporation (RTC), have so routinely urged lower federal courts to apply state law against the directors and officers of federally chartered institutions.[16] If they truly believed that application of state law was inimical to the federal regulatory scheme as a policy matter, they surely would not have argued time and again — merely to gain a tactical advantage in a particular case — that state law liability standards *are* applicable.

Finally, as a policy matter, petitioner questions the wisdom of federalizing all internal corporate disputes that may arise with respect to federally chartered institutions. In the banking and thrift areas alone, there are literally thousands of such institutions. The real possibility exists, were the FDIC's federal common law position accepted, that an entire body of federal corporate common law would have to be developed in the various federal circuits and that, for federally chartered institutions, this Court would have to assume the role the Supreme Court of Delaware now assumes with respect to state-chartered corporations.

III. THE GROSS NEGLIGENCE STANDARD OF § 1821(k) DISPLACES ANY PRE-EXISTING FEDERAL COMMON LAW SIMPLE NEGLIGENCE STANDARD

Even if it were determined that City Federal could have asserted a federal common law claim for simple negligence against petitioner, the FDIC's right to assert that claim as City Federal's receiver would be supplanted by § 1821(k). Section 1821(k) authorizes the FDIC to sue, as receiver, "for gross

[16] In addition to *Stahl*, see *RTC v. Chapman*, 29 F.3d at 1122 ("According to the RTC, it may recover from [the federally chartered savings association's] directors and officers for simple negligence under Illinois law."), *RTC v. Shuck*, 1995 U.S. Dist. LEXIS 4314, at *3 ("The RTC counters that it is entitled to recovery under . . . the state common law simple negligence standard."), and *FDIC v. Raffa*, 882 F. Supp. at 1238 ("The FDIC contends that the officers and directors of [the federally chartered savings association] are liable for simple negligence . . . in violation of applicable Connecticut law . . . .").

negligence . . . or conduct that demonstrates a greater disregard of a duty of care" than gross negligence. It does not authorize suits for simple negligence.

The FDIC contends that § 1821(k) "is not the primary source of the FDIC's authority to pursue civil actions against officers and directors" but that "[i]nstead, the FDIC's authority derives primarily from its long-standing right as receiver, now codified at 12 U.S.C. 1821(d)(2)(A)(i), to succeed to all causes of action possessed by the depository institution." (FDIC Br. 31-32.) It is true that the FDIC, as receiver, succeeds to the claims of the insolvent institution and derives its authority, in the first instance, from § 1821(d)(2)(A)(i). But it is also true that in asserting claims as a receiver, the FDIC is limited by the terms of § 1821(k). Thus, § 1821(k) expressly provides that a director or officer "may be held personally liable for monetary damages in any civil action by . . . [the FDIC] . . . (1) *acting as conservator or receiver of such institution* . . . for gross negligence . . . ." (Emphasis added.) In short, if, *arguendo*, the institution had a federal common law claim for simple negligence, and § 1821(k) did *not* exist, then under § 1821(d)(2)(A)(i), the FDIC, as receiver for the institution, would step into its shoes and could assert the same simple negligence claim against the directors and officers. But § 1821(k) does exist, and it provides that, when the FDIC asserts a claim "acting as conservator or receiver of such institution," it may sue directors and officers of a federally chartered institution "for gross negligence . . . or conduct that demonstrates a greater disregard of a duty of care . . . ." Although it may wish to, the FDIC cannot treat § 1821(d)(2)(A)(i) and § 1821(k) as if they existed independently of one another.

In a similar vein, the FDIC argues that § 1821(k) "*empowers* the FDIC, at a minimum, to sue for gross negligence, while *preserving* the FDIC's right, in addition, to assert any federal common-law claims to which it may succeed as receiver." (FDIC Br. 30 (emphasis in original).) But the undeniable fact is that § 1821(k) applies to the directors and officers of *any* "insured depository institution," including federally chartered associations like City Federal. Congress simply could not have had any rational purpose in "empower[ing]" the FDIC to bring gross

negligence claims against the directors and officers of federally chartered associations if, as the FDIC maintains, the FDIC all along had the right — standing in the shoes of insolvent institutions under § 1821(d)(2)(A)(i) — to assert simple negligence claims under federal common law. The FDIC admits as much when it states: "It is true that Section 1821(k)'s authorization of suits for gross negligence may not afford the FDIC any practical advantage insofar as federally chartered institutions are concerned, because the FDIC already has the ability to sue officers and directors of federally chartered institutions for negligence under federal common law." (FDIC Br. 35.)

The only logical way out of this conundrum, consistent with the FDIC's position, is to assume that Congress acted mindlessly when it included within the scope of § 1821(k) "insured depository institutions" — a term that includes federally chartered associations — rather than limiting § 1821(k) to state chartered institutions only. That is unlikely, however, since "insured depository institution" is an expressly defined term in FIRREA, 12 U.S.C. § 1813(c)(2), as are the terms "Federal savings association" and "State savings association," 12 U.S.C. § 1813(b)(2), (3). Absent firmer evidence to the contrary — and the FDIC offers none — it should be assumed that Congress employed the broader term "insured depository institution" because it intended § 1821(k) to apply to federally chartered institutions, as well as to state chartered institutions, in a meaningful fashion. Section 1821(k) applies meaningfully to federally chartered institutions only if it is interpreted as the Fifth, Sixth, Seventh and Tenth Circuits have done — as authorizing suits for gross negligence, not offering a meaningless option to the FDIC to sue, as it may please, for gross negligence under § 1821(k) or simple negligence under federal common law.[19]

This interpretation necessarily requires that the term "other applicable law" in the savings clause of § 1821(k) not be read to

[19] The FDIC does not even acknowledge the existence of the four circuit court decisions holding that the gross negligence standard of § 1821(k) displaces any pre-existing federal common law simple negligence standard. *RTC v. Frates*, 52 F.3d 295, 297 (10th Cir. 1995), *FDIC v. Bates*, 42 F.3d 369, 373 (6th Cir. 1994), *RTC v. Miramon*, 22 F.3d 1357, 1364 (5th Cir. 1994), and *RTC v. Gallagher*, 10 F.3d 416, 424 (7th Cir. 1993).

embrace federal common law. Otherwise, the first sentence of § 1821(k), authorizing suits for gross negligence or conduct *more* culpable than gross negligence, is effectively eviscerated insofar as federally chartered institutions are concerned. It is, of course, an " 'elementary canon of construction that a statute should be interpreted so as not to render one part inoperative.' " *Department of Rev. v. ACF Indus., Inc.*, 114 S. Ct. 843, 848 (1994) (quoting *Mountain States Tel. & Tel. Co. v. Pueblo of Santa Ana*, 472 U.S. 237, 249 (1985)). Accordingly, the better reading of the savings clause is that the reference to "other applicable law" preserves applicable state law actions with lesser liability standards than gross negligence. That is precisely what the FDIC successfully argued before the Eleventh Circuit in *FDIC v. Stahl*. The court there observed:

> While § 1821(k) provides that a director may be held liable for gross negligence, the FDIC contends that Congress enacted the last sentence of the statute to permit courts to decide whether to apply state law to federally chartered financial institutions. We reach the same conclusion. That is, we find that the "saving language" in the last sentence of the statute enables claims under "other applicable law," i.e., state law for simple negligence, to survive the enactment of FIRREA.

89 F.3d 1510, 1515 (11th Cir. 1996).

The FDIC relies on the Court's opinion in *Patterson v. Shumate* for the proposition that "other applicable law" means *all* law, including federal common law. (FDIC Br. 33-34.) The Court ruled in *Patterson* that the phrase "applicable nonbankruptcy law" appearing in § 541(c)(2) of the Bankruptcy Code was not limited to state law, as petitioner contended, but encompassed "any relevant nonbankruptcy law, including federal law such as ERISA." 504 U.S. 753, 759 (1992). *Patterson* is inapplicable because there was no suggestion that interpreting "applicable nonbankruptcy law" to embrace federal law, including ERISA specifically, would render § 541(c)(2), or any other provision, of the Bankruptcy Code meaningless, in whole or in part. That is simply not the case here. If "other applicable law" in the savings clause of § 1821(k) is interpreted to include federal common law

claims for simple negligence, then the first sentence of § 1821(k) is rendered utterly meaningless insofar as federally chartered institutions are concerned.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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August 30, 1996